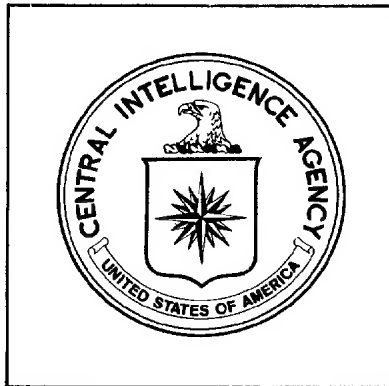


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Latin America

REGIONAL AND POLITICAL ANALYSIS

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This publication is prepared for regional specialists in the Washington community by the Latin America Division, Office of Regional and Political Analysis, with occasional contributions from other offices within the Directorate of Intelligence and from other agencies within the Intelligence Community. Comments and queries are welcome. They should be directed to the authors of the individual articles.

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The OAS General Assembly and the Human Rights Issue

25X1 [] Delegates to last week's OAS General Assembly in Grenada returned home convinced of the sincerity of Washington's commitment to the defense of human rights. The conference, in fact, turned out to be a battleground for the US human rights policy, and almost all of the discussions were devoted to it. Even though the delegates have been thoroughly sensitized to the issue, the outlook for progress in curbing human rights abuses is still mixed at best.

25X1 [] The 13 nations voting for the US initiative on human rights were: Panama, Jamaica, Barbados, Surinam, Grenada, Costa Rica, Trinidad, Mexico, the Dominican Republic, Ecuador, Haiti, Venezuela, and Peru. Seven of these are Caribbean countries. Five are countries visited by Mrs. Carter in early June. The southern cone countries of Brazil, Argentina, Chile, Paraguay, and Uruguay abstained--a polite "no" vote--as did Guatemala, Colombia, and El Salvador. Honduras, Nicaragua, and Bolivia did not vote.

25X1 [] It has been apparent for some time now that US spokesmen, including Mrs. Carter, Secretary Vance, and Ambassador Young, have been getting the human rights message across to the Latin Americans. The doubts about Washington's long-term seriousness on the issue have given way in many cases to concrete action by several of the countries to curb the worst abuses. For example, Chile claims that it has freed its last political prisoner. While the OAS was in session the Chilean government also negotiated the settlement of a hunger strike, staged by families of missing persons, that has been in progress at the UN Economic Commission for Latin America headquarters in Santiago. Argentina and Brazil have directed security forces to be more circumspect when arresting suspected terrorists. Paraguay is again talking about inviting the Inter-American Human Rights Commission to make an on-sight inspection in Asuncion.

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25X1 [] These positive steps, however, do not mean that the OAS community will soon develop a unanimity of views on the human rights issue. Although no country would ever voice opposition to the defense of human rights intrinsically, the reasons for the negative votes continue to be fear of political and economic destabilization caused by communism and terrorism. The psychological and real factors are unlikely to go away in the near future. In fact, it is conceivable that some of the countries voting with the US on this issue may be faced in the future with a security problem that could lead to systematic violations of human rights. Haiti, for example, already has one of the worst records in the hemisphere on human rights. Politically related violence is already common in Jamaica, always threatening in Panama, and never far from the surface in the Dominican Republic. Haiti's vote for the US resolution is difficult to understand; Ambassador McGee believes the Haitians had decided to vote yes on everything that came up at the meeting.

25X1 [] The positive votes by Jamaica, Costa Rica, Ecuador, Peru, and Venezuela could well have been influenced by Mrs. Carter's visit to these countries. More than likely, however, other considerations were just as important. Even though Mrs. Carter reportedly was assured by Jamaican Prime Minister Manley that he would support the US on human rights, Manley was effusive in his praise for President Carter on the human rights issue well before Mrs. Carter's trip. Moreover, Jamaica sorely needs US financial assistance now. Costa Rica and Venezuela, two of the few practicing democracies in Latin America, would be expected to support the US, as would Mexico.

25X1 [] An Ecuadorean spokesman has said that his country's vote for the US resolution stemmed from a sincere belief in human rights. Another Ecuadorean said, however, that Quito has an ambivalent attitude toward the issue because it could be construed as interference in internal affairs. He added, however, that the government had decided to support the US policy before Mrs. Carter's visit and could not change its position even if it wanted to. Both denied that the possibility of acquiring arms from the US was a factor in their vote, but the

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Ecuadoreans are again inquiring about US aircraft. In the case of Peru, the positive vote was not surprising. Peru has generally supported public declarations of human rights, and it is believed that the US declaration on human rights will be incorporated into the new Peruvian constitution.

25X1 [] The support for the US position by Barbados, the Dominican Republic, Panama, Surinam, Grenada, and Trinidad-Tobago was not unexpected, but Jamaica had to put pressure on the Grenadans in order to get their vote. Progress in the canal negotiations certainly was a factor in winning Panama's vote.

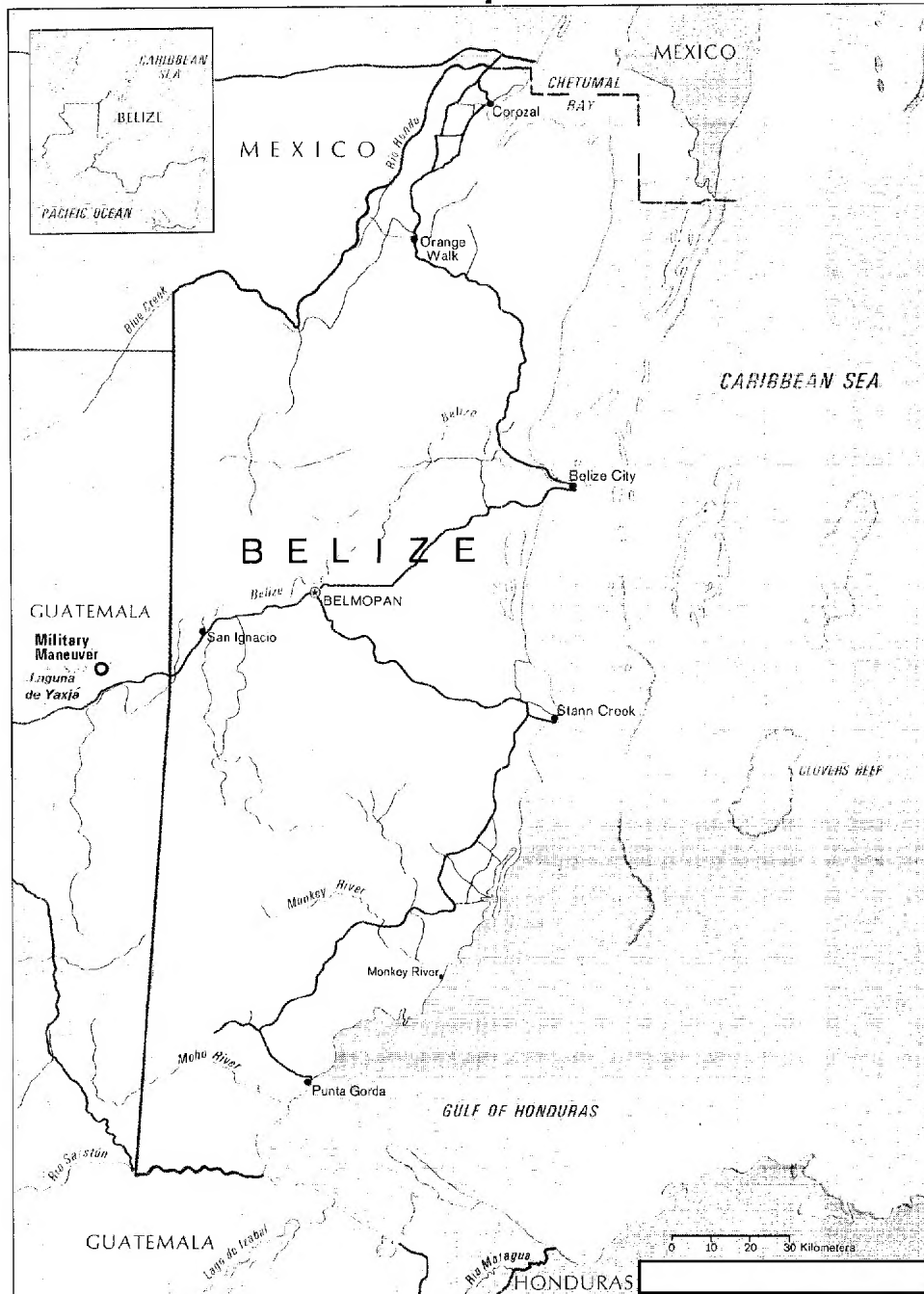
25X1 [] In the final analysis, the Grenada meeting of the OAS may be remembered in the future as the beginning of a new era of understanding between the US and Latin America, or it may go down as the final dissolution of the special relationship most Latin American countries have long assumed they enjoy with Washington. Despite the US victory on the human rights issue, the voting pattern raises disturbing questions. The southern cone countries remain a solid intransigent bloc, with Brazil emerging as a leader of this faction and exerting its influence to a certain extent over Bolivia and Colombia. The US is thus left with solid support from Mexico, Venezuela, Ecuador, Peru, and the Dominican Republic among the Spanish-speaking countries. Continued backing for US initiatives from the English-speaking Caribbean appears to be tenuous at best and may, in the long run, be contingent on the willingness of the US to provide economic assistance.

25X1 [] All of the Latin nations are now aware, however, that the issue of human rights is the fundamental basis of inter-American cooperation--at least in US eyes. The linkage of US assistance to human rights is bound to have a great impact on Latin America. It remains to be seen if it will be positive or negative. [] 25X1

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GUATEMALA-BELIZE: Military Maneuvers



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Guatemala-Belize: Dispute Escalates Again

25X1 [] In the latest of a series of escalating maneuvers, the Guatemalan army has initiated a week of military activities on the border with Belize, presumably to put pressure on the UK in the continuing negotiations over Guatemalan claims to the British colony. Other Guatemalan moves also continue to point to serious preparations for military action if negotiations fail.

25X1 [] The British were officially informed by Guatemala of the military exercises. The maneuvers, along with a recent limited mobilization--or at least stepped-up training--of military reserves, seem designed primarily for diplomatic impact before the Guatemala-UK talks on July 6 and 7. Although some British officials view the Guatemalan moves as irrational, President Laugerud apparently believes the British are at least seriously considering terminating the talks, and he is out to convince them that such a move would raise a serious risk of military conflict.

25X1 [] In response, British forces in Belize--about 1,300 men--have gone to the second stage of a four-stage alert system. The British may well proceed with a limited reinforcement, which has been under consideration.


25X1 [] Guatemala has indicated it will present its minimal demands during the talks in Washington. Recent reporting has indicated President Laugerud is focusing on a single cession of territory in Belize south of the Monkey River. The Guatemalans have, however, at times discussed the Moho River line--a much smaller piece of territory--as a fall-back position. As a result, we believe there is still give in the Guatemalan stand on this point of a territorial settlement.

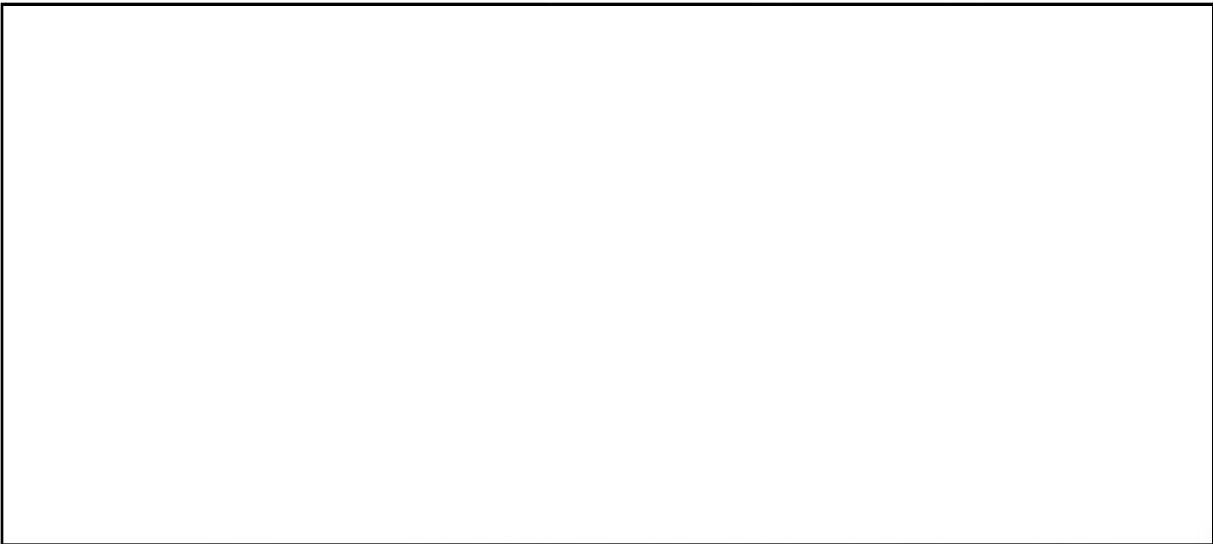
Guatemalan-UK relations were further strained this past week when authorities in Barbados--suspicious about the cargo of a transiting plane--detained an Argentine


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25X1  aircraft which was en route to Guatemala with a large shipment of ammunition. Guatemala termed the action by the former British dependency a "UK provocation" that demonstrated a lack of interest in a peaceful settlement of the Belize dispute. Aside from the increase in the level of the rhetoric, the Guatemalans are obviously seeking to bolster their stock of 5.56-mm ammunition for the 15,000 Galil rifles they recently purchased from Israel.

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25X1  Laugerud's room for maneuver is also limited by domestic political complications. Guatemala is now entering the campaign period for the March 1978 presidential elections in which the government-backed candidate could face a hard fight. The country is also again experiencing increased political violence. A prominent leftist attorney was assassinated on June 8 and there have been two attempts to kidnap sons of wealthy businessmen this month. Business leaders recently attempted to prevail upon Laugerud to impose a state of siege and crack down on the left or allow the creation of extra-legal anti-terrorist groups. Immediately following Laugerud's reported refusal to authorize paramilitary units, a new right wing group, the Secret Anti-Communist Army, announced its existence.

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114 Faced with these domestic difficulties and the prospect of escalating left-right violence, Laugerud can ill afford to be perceived as a weak leader. In part, this accounts for his hard line pronouncements on the Belize issue. In a speech this week, he again warned of the possible need to take up arms to confront aggression by Great Britain and pledged, as commanding general, "to be at the head of all."

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Argentina - North Korea: Break in Relations

Argentina recently severed diplomatic relations with North Korea after Pyongyang's entire mission had abruptly left the country. The break was largely a product of the suspicion with which the Videla government has viewed North Korean activities in Argentina. The move undoubtedly pleased the highly conservative Argentine navy, which controls the Foreign Ministry.

The North Koreans contend that they left Argentina because of harassment and surveillance by Argentine security and intelligence services. A note of explanation to President Videla stated that until the situation improved, North Korean diplomatic matters with Argentina would be handled by the mission in Cuba; no mention was made, however, of ending diplomatic relations.

The staunchly anti-Marxist government in Buenos Aires, suspicious that communist aid is going to subversive groups in Argentina, has long kept close watch on the communist missions. Official Soviet and Romanian personnel, as well as communist news correspondents, are restricted to a limited area in and around Buenos Aires, and North Korean staff members were also under travel restrictions.

Recent reports indicate that Argentina intended to reduce the number of both North Korean and Cuban personnel assigned to their embassies in Buenos Aires. The decision to do so apparently was awaiting an assessment of economic and political benefits and losses.

The North Koreans have steadily reduced the staff of their mission in Buenos Aires over the past year in response to obvious Argentine irritation about improprieties and the crude behavior of North Korean diplomats.

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Peru: Government Contains Austerity Protests

25X1 [] The Peruvian government, thus far, has succeeded in containing public protest demonstrations triggered by the harsh new economic plan announced on June 10. Bank officials, meanwhile, are hopeful that early International Monetary Fund approval of the new plan will pave the way for balance-of-payments support loans that Peru badly needs.

25X1 [] The government has moved swiftly to localize the protests which have taken place in most major cities by rapidly deploying security forces, imposing curfews, and making hundreds of arrests.

25X1 [] The most serious disturbances occurred in the southern cities of Cuzco and Puno. On June 15 and 16, Cuzco was the scene of a confrontation between leftist students and police which deteriorated into general rioting before the civil guard could restore order. During protests over food price increases in Puno on June 23, a train was derailed and a police station and several other government buildings were burned. Further demonstrations, though much less severe, have occurred in Lima, Arequipa, Ayacucho, and several smaller localities.

[] Students, with encouragement from leftists, remain the principal agents in the disturbances, with organized labor playing a far less conspicuous role. Localized strikes in support of the students have been only partially successful--undoubtedly the result of government threats of immediate punishment for workers who participate.

[] Although talking tough with union leaders may be sufficient to keep labor at bay, the government continues to fear an open confrontation with the workers. It will face further challenges on June 30 when bank workers

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plan to strike in Lima, and again on July 5, when a nationwide strike has been scheduled by the far-left teachers' union.

25X1 Peruvian banking officials are optimistic that a team from the International Monetary Fund, now visiting Lima, will find the new economic measures an acceptable response to conditions imposed by the Fund last March for a standby loan. If agreement is imminent, as these sources suggest, discussion with New York commercial banks concerning further balance-of-payments assistance--which has been contingent upon the IMF loan--could begin as early as this weekend.

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Venezuela: Down to the Wire

More than a million registered members of the governing Democratic Action Party (AD) will cast their votes on July 17 in a nationwide direct primary to select a presidential candidate for the general election in December 1978. Several weeks later, the opposition Social Christian Party of former president Rafael Caldera and the Marxist Movement Toward Socialism will each select their standardbearers, actions which will all but officially launch the start of what is likely to be a sharp and bitterly fought campaign.

A Unique Approach

The AD's new selection experiment is a radical departure from the complex five-level system used in the past to choose the party's National Convention delegates, who, in turn, selected the presidential candidate. This new system involves open assembly voting for delegates, starting at the base of the party's pyramidal structure and proceeding upward through municipal and state committees. A side effect of the system is to reduce the traditional influence of party power brokers who formerly dictated the party's choice at the party convention. Now, an element of uncertainty has been added both because secret ballots will be cast and by the fact that all party members are eligible to participate, thus ensuring a large vote. The universal suffrage experiment will be limited to presidential primaries; legislative and other elective posts will still be filled through the traditional system. Although some older party leaders consider the electoral reform transitory, there is widespread pressure from younger AD members to institutionalize the new system. It may even be a precursor of further changes that will affect other parties as well. Venezuela's traditional system of obligatory party block voting for congressional

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and municipal posts, where a split ticket is impossible, is under heavy fire from an electorate largely composed of independent voters.

Two Man Race

Supporters of both major candidates, AD congressional whip Jaime Lusinchi and party secretary general Luis Pinerua Ordaz, are predicting victory. The feverish activity in both camps belies this confidence, however, and suggests that both men consider the next few weeks critical. Former president Romulo Betancourt had made clear his strong preference for the party's secretary general and has stated privately that he is determined to do whatever is necessary to secure the nomination for Pinerua. His statement may reflect some anxiety that Pinerua's campaign has stalled in recent weeks while Lusinchi's campaign, starting virtually from nowhere six months ago, is beginning to pay off at the grass roots level, offsetting to some extent benefits Pinerua receives from his tight grip on the party machinery.

By again taking an active role within the party and the country, Betancourt, the party's "president for life," has directly challenged President Carlos Andres Perez over the question of party leadership, especially as it relates to the choice of the party's 1978 presidential candidate. Perez is known to favor Lusinchi and some of Perez' closest advisers publicly support him. The President, a strong-willed man, will not take lying down Betancourt's reassertion of a leadership role for himself within the party. Neither will Perez tolerate remarks openly critical of major aspects of his foreign policies. While Perez has not openly challenged Betancourt, he has issued thinly veiled public rebuttals to Betancourt's analysis of foreign policy issues.

A Party in Transition

The struggle for the party nomination has tended to overshadow the fact that the AD is going through a period of considerable soul-searching and strain as it approaches the elections. The aging fathers of the

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party, Betancourt and Gonzalo Barrios, are nearing the end of their political careers, but still retain enormous party power. President Perez, 53 years old, has great influence, but is something of a lame duck since he cannot become a candidate for president again for ten years after he leaves office. This explains in part his great interest in demonstrating his political skills on the domestic and international levels in an effort to obtain a secure hold on the party leadership when Betancourt departs the scene. The competition within the party also represents something more than the rivalry between two well-known politicians; it is also a clear reflection of the changing times in the country.

Lusinchi has not defined his political goals very well, but he insists that the old-line leadership, Betancourt and Barrios among others, is no longer representative of the Venezuela of 1977. Lusinchi is more at ease with the big merchants and industrialists and less dependent on the traditional base of the party, the unions and peasants. In keeping with what his supporters believe to be the present day Venezuelan reality, he seeks to project a more sophisticated and polished image than his rival.

Pinerua is more representative of the AD party which was formed under the Gomez dictatorship during the 1930s--an organization made up largely of workers, peasants, and small-business men. He is more provincial, suspicious of big-city ways and big business, and is firmly opposed to the Communists and any kind of deals with them. He is also critical of the corruption and immorality that he feels are characteristic of many of the newly rich elements of Venezuelan society.

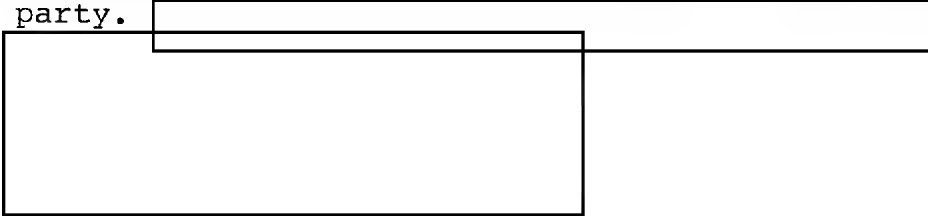
A Challenge

The problem facing the Democratic Action Party is to determine how much the country has changed since the last general election--before massive oil-generated revenues poured into the country--and how many people have changed with it. If the AD is to continue to claim to represent the Venezuelan average man, it will have to decide who he is. While he may no longer be the "Juan Bimba" in peasant attire and sandals, he is probably also not the well-dressed young man riding

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around Caracas in a Mercedes. Lusinchi and Pinerua serve as opposing symbols for what the party is and what its future role is to be. This explains the feeling of many party leaders who see that what is at stake is not necessarily the political fortunes of two very ambitious politicians but the control of the ideological heart and soul of Venezuela's largest political party.



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Paraguay: Stroessner and the Press

25X1 [] President Stroessner has repeatedly demonstrated his ability to perpetuate his stay in office by manipulating "democratic" procedures. Now, he apparently is moving behind the scenes to gain control over the Paraguayan press.

[] Within the past few months two evening newspapers have been started in Asuncion, apparently to compete with the morning daily *A B C Color*, the only Paraguayan periodical that occasionally criticizes the government. Both new publications are said to have financial backing from pro-government sources, and the principal stockholder in one launched this month is Stroessner's son-in-law, Humberto Dominguez Dibb.

25X1 [] Stroessner recently took strong exception to a statement by the Inter-American Press Association that there is no freedom of the press in Paraguay, but he has frequently been sensitive to public criticism of his policies. On one occasion, he jailed the editor of a newspaper for publishing a joke about the Chaco War that was apolitical, but one that Stroessner considered to be in poor taste. Most newspapers practice self-censorship and even *A B C Color* refrains from attacking the President directly.

[] Nevertheless, *A B C Color* has probably aroused official ire by its repeated criticism of the terms of the Itaipu hydroelectric project which, it alleges, constitutes a virtual sell-out to Brazilian interests, and by the paper's propensity to call attention to the grosser abuses of the contraband trade--reportedly run by some of Stroessner's closest associates.


25X1 [] According to estimates of the United States Information Agency, the two new dailies already have achieved a combined circulation of approximately 55,000 rivaling that of *A B C Color*. They also enjoy the latest offset

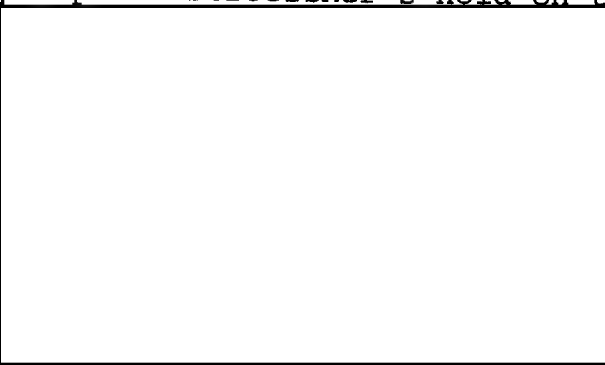
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presses and new typesetting and photo-reproduction equipment--all purchased in the US. *A B C Color*, however, also has considerable financial resources and is not likely to fold in the near future.

25X1  Stroessner may be planning additional moves. According to one report, he and several associates, including his son-in-law and Army Commander General Rodrigues, plan to launch a weekly magazine and a third television station (the two Paraguayan channels now in operation are state-controlled). Such developments would virtually complete Stroessner's hold on the country's media.

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Bolivia: Pressures To Return to Democracy

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Demands from various public sectors have resulted in a ground swell of pressure on the government to open the way for a resumption of political activities. President Banzer has responded by reassuring the nation that Bolivia will be "constitutionalized" by 1980 but at the same time he is monitoring the momentum being created by unofficial political activities.

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Over 100 prominent Bolivians, including former officials of the current government, peasant and labor leaders, retired military officers, and former president Luis Adolfo Siles, signed a published letter calling for elections by 1978 and an end to the suspension of political parties and trade unions imposed in 1974. The letter was probably precipitated by a speech in which Banzer announced that Bolivia would not return to a "formal democracy," which he termed a "great hypocrisy."

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The latest official declaration restates what has become a familiar theme--that the "transitory" Banzer government intends to "institutionalize" Bolivia and provide for a "new" democracy beginning at a "moment best suited to the national interests." He reiterated his three-stage plan for democratization: institutional stability, which has already been accomplished; strengthening of economic and social structure, now in progress; and democratic institutionalization. Banzer apparently has consulted with his advisers about the restoration of democratic principles, but as yet has neither defined the "new" democracy nor decided how it will come about. In fact, the President's remarks go no further than the armed forces "Plan for a New Bolivia"--issued last October--which offered a justification for continued military rule and a rough blueprint for the country's future.

The Banzer regime is clearly opposed, however, to the reactivation any time soon of traditional political parties. In early June the President said that he would

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not permit a return to "false democracy." Minister of Interior Pereda coincidentally made a statement precluding the lifting of the 1974 decrees that suspended political and labor union activities. A recent official communique says that to return "to politicking is to vitiate democracy, check development, and prevent civilized coexistence." These statements characterize La Paz's reactions to the increasing efforts of the two major Bolivian political parties, the Nationalist Revolutionary Movement (MNR) and Bolivian Socialist Falange (FSB), to regain the right to engage in political activity.

The FSB has for some time been insisting it will hold a national convention in August to plan future activities. The MNR demanded elections in an open letter published on the 25th anniversary of the 1952 revolution in April. Both parties have been sharply reminded that the ban on political activity is still in force. Banzer further warned that parties would be allowed to resume activities only when they could guarantee "unity, well being, peaceful coexistence, and political stability for every citizen without exception."

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Banzer is undoubtedly concerned about the potentially destabilizing effect on his government of lifting the lid off party activity. At a minimum, the strong official criticism directed toward the MNR and the FSB is intended to retard their efforts toward constitutionalization, while ensuring Banzer's continued control over the direction and rate of the process. More important, the government's censure of the parties may be signaling the end of the truce under which the MNR and FSB have existed with the Banzer regime since the installation of the all-military government three years ago.

In any case, the official reaction to the demands for democratization will probably not satisfy political opposition leaders. The government's vague and repetitive response to their demands offers little beyond making the 1980 deadline less reversible. Criticism of the Banzer regime's rule by decree is likely to continue as is the call for more explicit plans for Bolivia's future.

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Bahamas: Election Campaign

The popularity of Prime Minister Lynden Pindling and his Popular Liberal Party (PLP) appears to have slipped in the last year. The fragmentation of the opposition, however, is likely to allow him to return to power in the July 19 House of Assembly election, although perhaps with a reduced margin.

Elected in 1967 as the first black head of government, Pindling enjoyed wide popularity. He strengthened his position by leading his country of 213,000 inhabitants to independence in July 1973 and by chartering a generally moderate though nationalistic course. In recent months, however, he has had to beat back challenges even from within his own party.

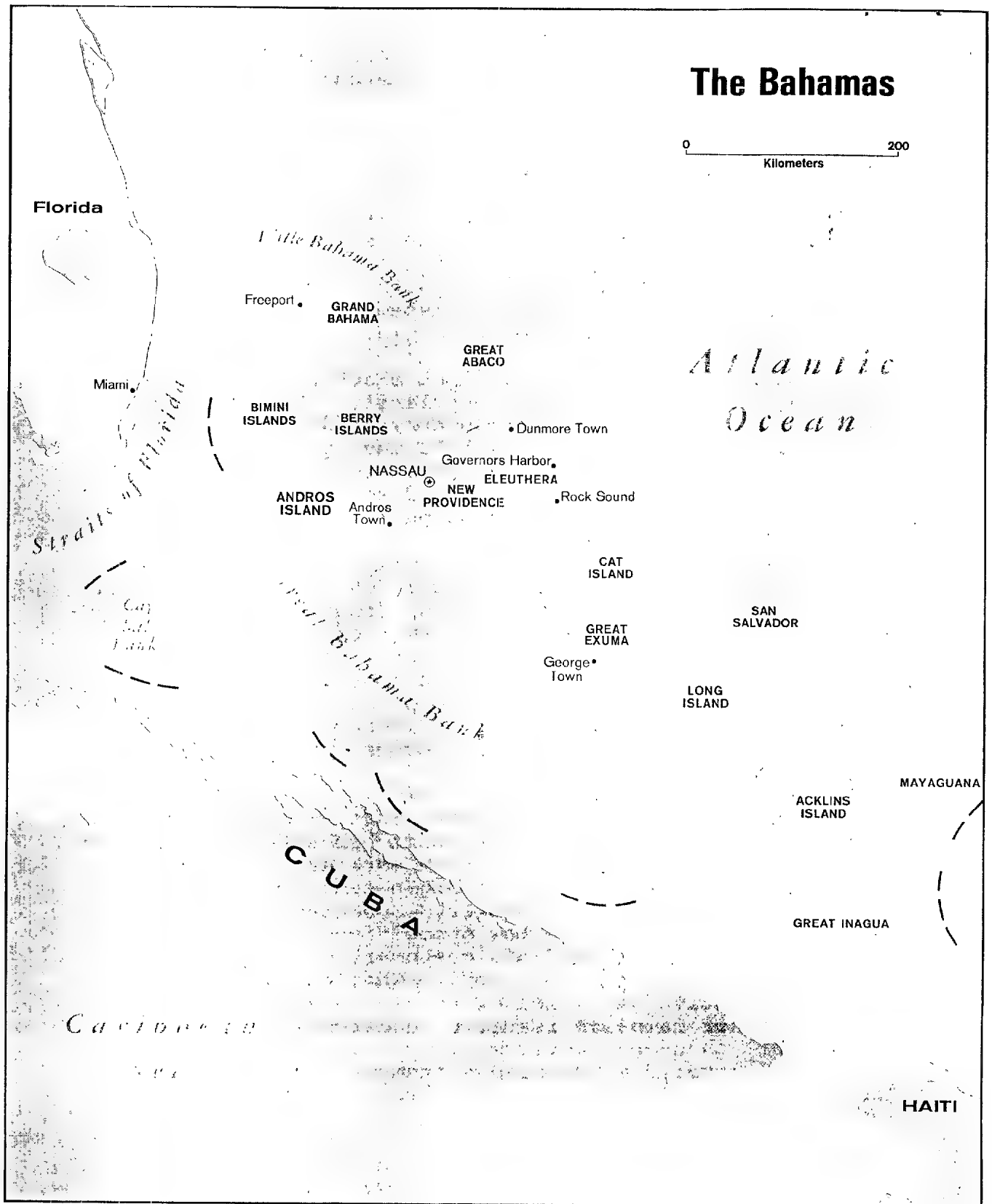
Opposition to Pindling from within the PLP culminated in May when a group of backbench "rebels"--opposed to Pindling's increasingly personal control of the party--tried to thwart the Prime Minister's efforts to manage the party's nomination process. Only after threatening to resign did Pindling succeed in dropping 10 members of parliament from the party's list of candidates. Many of these individuals are running as independents and their strength in their home constituencies could cost the PLP several seats.

Pindling's growing awareness that he may be in for a tough battle led him to cut short his attendance at the Commonwealth conference in London earlier this month so that he could return home and begin campaigning. He got off to a bad start, however. Speaking to a rally of party faithful and not a few opposition hecklers on June 13, Pindling lacked his customary charisma and misjudged the mood of the crowd. Challenged in advance by an opposition party leader to use the occasion to discuss major campaign issues of underemployment--especially of youth--and government corruption, Pindling instead delivered a prepared statement concerning the results of the Commonwealth conference.

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25X1 [redacted] Pindling is now on the defensive, but he is likely to be saved by the fact that the opposition is even more divided than the ruling party. Last December, the parliamentary faction of the major opposition party, the Free National Movement (FNM), broke away and formed the Bahamian Democratic Party (BDP) led by Henry Bostwick. In April, the BDP and FNM made a last ditch attempt to submerge their differences--which are based more on personality than on ideology--and to present a single list of candidates. Efforts at conciliation failed, however, and now both parties are running nearly a full slate of candidates for the 38 available seats.

The BDP was originally expected to have more voter appeal than the FNM but has so far concluded a lackluster campaign. In addition, Pindling appears to be having some success in exploiting the reputation of the BDP as a spokesman for the white business community. The FNM remains basically a creature of its controversial leader Cecil Wallace-Whitfield, who left the PLP in 1970. It is offering a group of young, mainly untested candidates, but the party has so far had surprising success in attracting new voters. In the unlikely event that Pindling fails to obtain a majority, he might well strike an alliance with Wallace-Whitfield.

25X1 [redacted] This election offers little prospect of a significant change of course in The Bahamas since neither of the ruling party's two major challengers offers a program that differs markedly from that espoused by the government. There are forces at work below the surface, however. The Bahamas has been less affected by the more militant ideologies and movements--such as black power in the early 1970s and more recently third world socialism--than have other countries in the Caribbean. As young people from the isolated "out islands" continue to migrate to the overcrowded, unemployment plagued main islands of New Providence and Grand Bahama, a breeding ground for adherents to more radical political movements may be forming.

More immediately, the government is likely to come under increasing pressure as the campaign progresses to shake its image as a haven for geriatric "fat cats." It has to persuade the electorate that after 10 years of rule it maintains its dynamism and is not indifferent to the country's socio-economic problems. [redacted]

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Netherlands Antilles: Election Outcome

25X1 [The victory of Sylvius G. M. "Boy" Rozendal and his Democratic Party in the June 17 Staten elections is likely to ensure continued centrist leadership and will enhance the prospects for an accommodation with separatist forces in Aruba.

[With a combination of business and labor support the Democratic Party won 6 of a possible 12 seats from the federation's largest island, Curacao. The Staten has a total of 22 seats. Rozendal will replace Juan Evertsz as Minister President and is currently in the process of forging a new coalition. The major loser was Wilson "Papa" Godett and his left-leaning Workers' Party of Liberation (FOL). The strongest party on the island following local elections in 1975, the FOL won only three seats this time. The FOL's poor showing was due in large part to successful efforts by its opponents to arouse popular suspicion that Godett planned to bring Cuban-style socialism to Curacao. The FOL may be hard pressed to remain united as new leaders, including the dynamic Don Martina, try to give the party a new direction.

25X1 [As expected, Gilberto "Betico" Croes and the People's Electoral Movement (MEP) were the big winners in Aruba where they captured five of the eight Staten seats. The election outcome has reinforced Croes' belief that he has broad popular support for moving toward Aruban separation from Curacao. Croes hopes to join the new governing coalition and reportedly would settle in the short run for a government commitment to grant Aruba increased local autonomy. Croes has threatened to demand immediate separation for Aruba, however, if the MEP is excluded from the coalition.

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[REDACTED] The composition of the new coalition is still uncertain, but Rozendal reportedly favors establishing a government that would include the MEP, as well as the Aruban Patriotic Party (PPA), and a representative from Bonaire. To form this coalition Rozendal is apparently willing to make concessions to the MEP by moving toward a more decentralized system of government. In addition, he will undoubtedly have to overcome the resentment the PPA must feel toward the MEP, following a campaign that saw Croes' followers resort to violence to prevent the PPA from opening a campaign headquarters. [REDACTED]

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[REDACTED]

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Mexico: Foreign Financial Gap

| | 1973 | 1974 | 1975 | 1976 ¹ | 1977 ² |
|---|---------------|---------------|---------------|-------------------|-------------------|
| | Million US \$ | | | | |
| Current account deficit | 1,175 | 2,558 | 3,769 | 3,024 | 2,400 |
| Debt amortization ³ | -845 | -596 | -839 | -1,141 | -1,600 |
| Financial gap | -2,020 | -3,154 | -4,608 | -4,165 | -4,000 |
| Medium- and long-term capital inflows | 2,520 | 3,326 | 5,179 | 6,031 | 5,200 |
| Official borrowing | 1,962 | 2,739 | 4,349 | 5,032 | 4,500 |
| Direct private investment | 287 | 362 | 362 | 331 | 400 |
| Other net private inflows | 271 | 225 | 468 | 668 | 300 |
| Net short-term capital and errors and omissions | -378 | -136 | -406 | -2,199 | -300 |
| Change in reserves | 122 | 36 | 165 | -333 | 900 |
| Other financial items: | | | | | |
| External public debt yearend (including short-term) | 7,617 | 10,497 | 14,449 | 19,600 | 22,500 |
| | Percent | | | | |
| Debt service ratio (public medium- and long-term) | 25 | 18 | 29 | 36 | 45 |
| | Million US \$ | | | | |
| Exports, f.o.b. ⁴ | 2,348 | 3,293 | 3,313 | 3,818 | 4,600 |
| Imports, c.i.f. | 3,813 | 6,057 | 6,580 | 6,030 | 5,900 |

1. Provisional.

2. Projected.

3. Including amortization of public and publicly guaranteed debt, the great bulk of the medium- and long-term debt.

4. Including value added by border industry operations.

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Mexico: International Financial Situation and Outlook

25X1 [] The Mexican economy is passing through a difficult readjustment period, but its future remains exceptionally bright. Sharply rising debt amortization obligations will keep the foreign financial gap* large this year despite extreme austerity measures. The pace of future improvement will depend on how rapidly Mexico City develops its new-found oil reserves and what rates of economic growth it decides to maintain. By 1980, Mexico could be achieving substantial current-account surpluses; at worst, it should be running a considerably smaller deficit.

The Oil Crisis Period

25X1 [] Mexico's foreign financial gap more than doubled between 1973 and 1975, to \$4.6 billion, mainly as a result of a worsening trade imbalance. During this period, the higher oil bills that plagued other LDCs were not a problem for Mexico; in fact it had become a net oil exporter by 1975. Nonoil imports nearly doubled because of:

- A highly import-intensive program of public investments.
- Inventory accumulation spurred by inflationary expectations.
- Shortfalls in domestic food production due to poor weather and low government support prices.
- The steady inflation of Mexico's cost-price structure relative to those of its major trading partners.

**In this article, financial gap is defined as the current-account deficit plus amortization of medium- and long-term debt; shifts in short-term capital are not included.*

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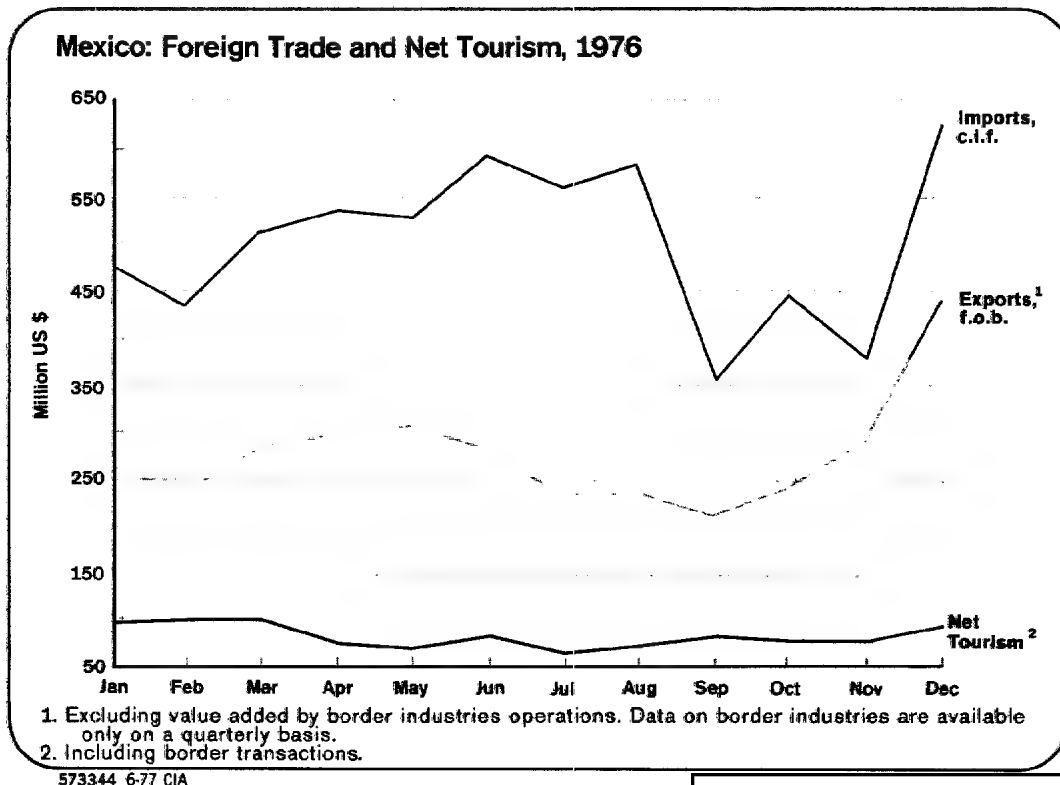
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Export earnings grew by 40 percent in 1974 but stagnated in 1975 as recession struck world commodity markets. Exports also suffered from a continued erosion in the international competitive position of Mexican manufactures and from poor harvests. By 1975, the trade deficit totaled \$3.3 billion, compared with \$1.5 billion in 1973.

To make matters worse, the services account--traditionally in substantial surplus--shifted into the red in 1974 and registered a deficit of \$700 million in 1975. The predominant cause of the shift was a rapid rise in interest payments on external public sector debt, from \$378 million in 1973 to \$850 million in 1975. In addition, net earnings from tourism stagnated as Mexico's inflation outpaced the US rate by an annual average of 11 percentage points.

As news of its new-found oil riches spread, Mexico found it easy to tap private markets to meet the bulk of its foreign capital needs. Borrowing by the public sector--long the main user of foreign capital markets--increased from \$2 billion in 1973 to \$4.3 billion in 1975.



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25X1 [Throughout the period, Mexico continued its policy of borrowing somewhat more than it needed to cover the financial gap plus short-term capital losses to increase its foreign exchange reserves.

Paying the Piper in 1976

[Last year was probably the most difficult year for the Mexican economy in more than two decades. The financial gap narrowed in 1976 only because of the sharp drop in industrial production and real GDP that followed the loss of business confidence with the September float of the peso. Immense short-term capital flight both before and after the devaluation required a jump in foreign borrowing. Although medium- and long-term capital inflows rose to a record \$56 billion, Mexico City was still forced to draw on reserves to cover its needs.

25X1 [The substantial improvement in the current account in 1976 resulted from a \$1.1-billion drop in the trade deficit, split between a \$500-million increase in exports and a \$600-million reduction in imports. The 15-percent increase in exports was largely due to higher prices for agricultural products, particularly coffee, and increased petroleum sales. Exports of manufactures failed to respond to economic recovery in the industrial countries largely because they were not priced competitively prior to the peso float. Speculative import purchases prior to September were held down by licensing requirements imposed in mid-1975 and economic recession. With the further loss of business confidence following the floating of the peso, imports in the last four months declined by 25 percent from year earlier levels.

[Public sector foreign debt increased substantially in 1976 as the government again turned to foreign borrowing to increase public spending, to cover the financial gap, and--most important--to offset a short-term capital flight exceeding \$2-billion net. Public sector foreign debt, which accounts for the great bulk of total foreign debt, had climbed to \$19.6 billion by the end of 1976. Public debt servicing had increased by almost 40 percent, to \$2.5 billion, or 36 percent of exports of goods and services.

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Outlook for 1977

So far, the Lopez Portillo administration has placed adherence to an International Monetary Fund (IMF) agreement signed late last year and its own financial stabilization goals well ahead of economic expansion. Tight fiscal and monetary policies to control inflation will likely result in a year of zero or negative economic growth. The matching of last year's 2-percent increase in real GDP is probably the best that can be hoped for.

Austerity measures coupled with the 45-percent depreciation of the peso should dramatically improve the current account, but higher amortization payments will allow only a slight narrowing in the financial gap. The estimated \$600-million improvement in the current account results from an expected 40-percent decline in the trade deficit. Since Mexico City is expected to sharply increase its spending on imported equipment needed to expand petroleum production, the decline in the trade deficit is not as large as might be expected from the government's extreme austerity policies. Nevertheless, because of peso devaluation, economic stagnation, continued import controls, and increased domestic production of oil and chemicals, imports are expected to decline in value as well as volume. Imports were down 20 percent in January-April but should rise later in the year as the economy picks up, inventories are worked off, food imports increase, and, most important, Pemex increases its foreign procurement.

Exports are expected to increase 20 percent largely because of higher earnings from coffee and petroleum. Exports of manufactures and other goods will also be

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buoyed by low domestic demand, an improved competitive position, and the reinstitution of export incentives withdrawn last year.

25X1 [REDACTED] A sharp runup in debt servicing will hold down improvement in the financial gap. Servicing of the public medium- and long-term debt will require \$3.2 billion, yielding a debt service ratio of 45 percent; amortization payments alone will increase by \$460 million, to \$1.6 billion. As a result, the financial gap will decrease by only about 4 percent, to \$4 billion.

We estimate Mexico's total medium- and long-term capital needs this year at \$5.2 billion, an amount sufficient to cover the financial gap and moderate losses of short-term capital while adding \$900 million to international reserves. Official borrowing totaling \$4.5 billion would fall within IMF restrictions on net additions to debt. In addition, the government will have to roll over close to \$4 billion in short-term debt. [REDACTED]

[REDACTED] IF unable to obtain the necessary capital from the private market, Mexico can be expected to turn to international financial organizations and the US for additional assistance.

As a result of IMF limitations placed on government borrowing and the tighter credit situation, Mexico is looking for new sources to finance Pemex development programs. For the first time, it appears willing to commit future oil and gas exports to foreign companies in exchange for financing and other help in developing its vast oil potential.

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